

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Solis Analyst: Jeff Garnier Bill Number: SB 1661

Related Bills: See Leg. History Telephone: 845-5322 Amended Date: 6-15-00

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Child Care Facility Credit/50% of Costs for Facilities Serving Low-Income Children/Bank Loans Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

☒ DEPARTMENT POSITION CHANGED TO no position.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

☒ OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit in an amount equal to 50% of qualified expenditures, not to exceed specified limits, to any taxpayer that pays or incurs monetary contributions in excess of \$4,000 to a qualified child care facility located in California. This bill also would allow the proposed credit to reduce regular tax below tentative minimum tax (TMT).

Under the B&CTL, for specified loans relating to financing qualified child care and development facilities, this bill would allow a credit equal to 50% of the difference between the amount of interest income actually received and the amount of interest income that would have been received had the loan been made at one percentage point (100 basis points) above the prime rate.

SUMMARY OF AMENDMENT

Prior to the amendments, the bill contained language affecting the Department of Transportation and was not within the scope of the Franchise Tax Board's (FTB) duties.

The June 15, 2000, amendments removed the Department of Transportation language and inserted the child care facility and bank loans credit language.

Except for the revenue estimate, the two credits will be discussed separately.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input checked="" type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

7/7/00

1. CHILD CARE FACILITY CREDIT

EFFECTIVE DATE

This provision would be effective immediately upon enactment and would apply to taxable or income years beginning on or after January 1, 2001, and before January 1, 2006.

LEGISLATIVE HISTORY

AB 1923 (2000) contains language similar to the child care facility credit in this bill.

SB 549 (1999) proposed to expand the existing Child Care Facility Credit to include taxpayers that contribute costs for low-income facilities. This bill failed passage in Senate Appropriations. AB 401 (1999/2000) proposed to remove the sunset date of the Employer Child Care Contribution Credit and to allow a credit for child care expenses. This bill failed passage in Assembly Revenue and Taxation.

SPECIFIC FINDINGS

Existing federal and state laws provide for an alternative minimum tax liability, which ensures that taxpayers with credits, deductions, and other tax preference items do not completely escape taxation.

Existing state law allows employers a tax credit known as the Employer Child Care Program Credit. This credit equals 30% of the cost paid or incurred for (1) establishing a child care program or constructing a child care facility in California to be used by employees' children and (2) contributing to child care information and referral services. Building owners are allowed a credit equal to 30% of their costs to establish a child care program or facility to be used by the children of their tenants' employees. The amount of the credit is limited to \$50,000, even if 30% of the taxpayer's expenses exceed \$50,000. To the extent that the allowed credit cannot be used, a credit carryover is permitted. The carried-over amount may be added to any credit for that succeeding year, which is still limited to \$50,000.

Existing state law allows employers a tax credit known as the Employer Child Care Contribution Credit. The credit is equal to 30% of the cost paid or incurred for contributions to a qualified care plan made on behalf of any dependent under the age of 12 of the taxpayer's California employee, but only to the extent contributions are made directly to child care programs or providers. The amounts paid by the employer to child care providers can be in lieu of wages paid to the employees. The amount of the credit cannot exceed \$360 in any year for each qualified dependent, and any unused credit may continue to be carried forward until it has been exhausted.

This bill would allow a credit in an amount equal to 50% of qualified expenditures, not to exceed specified limits, to any taxpayer that pays or incurs monetary contributions in excess of \$4,000 to a qualified child care facility located in California. The credit would apply in taxable or income years beginning on or after January 1, 2001, and before January 1, 2006.

The bill would define "qualified expenditures" to include only monetary contributions made by a qualified taxpayer that do not exceed either \$400,000 for any single qualified child care facility or \$2 million in aggregate contributions for multiple qualified child care facilities. The \$400,000 and \$2 million maximums are cumulative and include amounts contributed in prior taxable or income years. The maximums also would include qualified expenditures made by any party related (within the meaning of IRC Sections 267 or 318, or as described in IRC Section 707(b)) to the taxpayer.

This bill would provide that a taxpayer could not utilize more than \$150,000 of the credit in any single taxable or income year. If the credit exceeds the \$150,000 annual limitation or exceeds the "net tax" or the "tax," any excess credit may be carried over for six succeeding years and applied on a "first-in, first-out" basis. The aggregate "allowable child care facility credit" for each taxpayer and any party related to the taxpayer for the taxable years the credit is authorized cannot exceed \$1 million.

A "qualified child care facility" would mean any new licensed child care facility or expanded (by at least 10% of child care capacity) existing child care facility located in California. It excludes in-home family child care or licensed-exempt care. A licensed child care facility also excludes a facility located in or on an occupied personal residence.

"Child care provider" is defined as the licensed owner or operator receiving the benefit of any cost paid, incurred, or contributed and claimed by a taxpayer. A child care provider is ineligible for the credit.

This bill would require the "child care provider" to do all of the following:

?? Certify that a written plan has been developed and maintained. The plan must reflect the child care provider's ability, for a period of five years, to recruit children from low-income families. The term "low-income families" means households that have incomes below 75% of the local area median income, as published by the U.S. Department of Housing and Urban Development or as defined in regulations issued by the State Department of Education.

And that either:

- ~~the~~ the child care provider has received approval to accept children from families qualifying for child care subsidies, or
- ~~the~~ the facility or proposed facility is or will be geographically located in or within one mile of a low-income area, as defined by the Community Reinvestment Act of 1977, as amended.

?? Certify that the costs for which the credit would be claimed have been incurred or will be incurred within the taxable or income year, with respect to constructing or expanding a child care facility, and that the provider has contracted to provide child care services for at least five years.

?? Provide the taxpayer with the provider's taxpayer identification number and a copy of the certifications required as discussed above.

?? Obtain the taxpayer's identification number and, in the case of a partnership, the taxpayer identification numbers of all partners.

?? On or before each June 1st immediately following each year for which the credit under this section is available, provide to the Department of Housing and Community Development with respect to that year a notice that includes all of the following:

- ~~the~~ the number and amount of tax credit certificates issued;
- ~~the~~ the taxpayer identification number of the child care provider receiving the benefit of the credit;
- ~~the~~ the names and taxpayer identification numbers of individuals, businesses, and types of businesses receiving the tax credit certificates; and
- ~~a~~ a copy of the certifications discussed above.

This bill would require the taxpayer claiming the credit to:

- ~~Provide~~ Provide the FTB, upon request, with documents verifying the date, amount, name, and taxpayer identification number of the child care provider in receipt of a qualifying contribution.
- ~~Provide~~ Provide the FTB, upon request, a statement from the child care provider certifying that the costs for which the credit is claimed are incurred with respect to constructing or expanding a child care facility in California to be used as certified by the child care provider.
- ~~Retain~~ Retain for his or her records a copy of the certificates issued by the qualified child care provider as discussed above and provide a copy of the certifications to the FTB upon request. If the taxpayer fails to comply with this requirement, no credit would be allowed to the taxpayer unless the taxpayer subsequently complies.
- ~~Provide~~ Provide the qualified child care provider with his or her name and taxpayer identification number and, in the case of a partnership, the taxpayer identification numbers of all partners.

This bill would require the Department of Housing and Community Development to provide a listing, upon request, to the FTB in a form, manner, and time to be agreed upon by the FTB and the Department of Housing and Community Development, of the following information:

- ~~For~~ For taxpayers making monetary contributions during the previous calendar year, the taxpayer's name, taxpayer identification number, and date and amount of monetary contributions made.
- ~~For~~ For child care providers receiving monetary contributions during the six preceding calendar years, the qualified child care provider's name, the taxpayer identification number, and the amount of the contribution made.

The bill would define "construct" or "expand" to include, but not be limited to, feasibility studies, site preparation, construction, renovation, or acquisition of facilities for purposes of establishing a new licensed child care facility or expanding an existing licensed child care facility that adds new child care capacity.

This bill would provide that the 60-month period requirement (not defined) would be suspended for any period that the child care provider uses to replace the property under an involuntary conversion, as described in Section 1033(a) of the Internal Revenue Code.

This bill would provide that a deduction would not be allowed, as may be provided elsewhere in the Revenue and Taxation Code, for the portion of the qualified expenditures equal to the credit allowed by this bill. Additionally, no credit would be allowed to a taxpayer that is required by a local ordinance or regulation to provide a child care facility.

This bill also would include the proposed Child Care Facility Credit in the list of credits that can reduce regular tax below tentative minimum tax for purposes of alternative minimum tax calculation.

Policy Considerations

Although this bill suggests that a child care provider is required to certify use of the qualified child care facility, no particular use of the facility is required. Consequently, a qualified taxpayer would be eligible for this credit regardless of whether child care is actually provided. A child care provider could provide the certifications required to be obtained by the taxpayer and not actually provide child care to low-income families or at all. The author may wish to consider requiring that a minimum percentage of low-income families actually receive services from the facilities to qualify for the credit.

This bill does not require the child care facility to be operated for a minimum amount of time. The bill states that the child care provider has to have a written plan to reflect the child care provider's ability to recruit children from low-income families for a period of five years and that the provider has contracted to provide child care services for five years. Making the credit conditional on creating a plan may not be as effective as a condition that actually requires the childcare services to be provided. A child care facility could be built and never opened or it could be operated for only one day and then be converted to another use. Under these facts, it is arguable that the taxpayer would still qualify for the credit. To ensure continuing compliance with the author's intent in providing this credit, the author may want to consider adding a credit recapture provision to the bill. To accomplish this, the bill could be amended to require a minimum time period during which the child care facility must be operated.

Implementation Considerations

It is unclear if the taxpayer would still be entitled to the credit if it were later determined that the certifications provided by the child care provider were incorrect.

It is unclear what the role of the Department of Housing and Community Development is in the administration of this credit. The Department of Housing and Community Development is not certifying any part of the credit. The only certification required by the bill is by the child care provider, who is also the person receiving the benefit of the monetary contribution. The Department of Housing and Community Development is collecting information from the child care provider and providing it to the FTB. The bill allows the FTB to request the same information from the taxpayer claiming the credit. In its present form, the FTB is responsible for the administration of this bill, which relates to the start-up and operation of child care centers. Generally, provisions allowing credits for transactions or behavior (the start-up and operation of a child care center) outside the scope of the FTB's expertise are certified by another state agency. AB 1923 (2000) contains the same child care facility credit except that the State Department of Social Services is responsible for certifying that credit.

There are a substantial number of undefined terms used throughout the bill. For example, the bill defines "child care provider" but repeatedly uses the term "qualified child care provider" which is undefined. In addition, the credit is based on "qualified expenditures" which is defined to mean monetary contributions "with respect to a qualified child care facility." However, the child care provider is required to certify that "the costs for which the credit is claimed have been or will be incurred with respect to constructing or expanding a child care facility." The credit is for any costs.

Technical Considerations

In defining the term "qualified taxpayer," the bill refers to an incorrect subdivision for the definition of a qualified child care provider. Amendments 1 and 2 would correct the reference.

2. CREDIT FOR INTEREST INCOME ON CHILD CARE AND DEVELOPMENT FACILITIES

EFFECTIVE DATE

This provision would be effective immediately upon enactment and would apply to income years beginning on or after January 1, 2000, and before January 1, 2010.

SPECIFIC FINDINGS

Existing state law allows a similar credit for interest income on loans used to finance qualified expenditures for farmworker housing (except that expenditures do not include the cost of acquiring a building or structure). **Existing state law** also allows taxpayers that make loans to businesses within an enterprise zone to deduct net interest.

Existing federal law taxes interest on federal obligations (e.g., bonds issued by the federal government) and allows the imposition of a state franchise tax on that interest if the state franchise tax is nondiscriminatory. (The tax imposed on the federal interest is not different than tax assessed on other interest.)

Under existing state law interest on state or local obligations (e.g., bonds issued by a state or political subdivision thereof) and interest on federal obligations are exempt from personal and corporate income tax but are included within the measure of the corporate franchise tax.

This bill would allow a credit for 50% of the difference between the interest income received on loans or the portions of loans used to finance the purchase, construction, expansion, or rehabilitation of qualified child care or development facilities, and the interest that could have been received had the loan rate been one percentage point (100 basis points) above the prime rate.

The credit allowed by this provision shall be claimed in equal installments over a period equal to the lesser of 10 years or the term of the loan. The period would begin in the taxpayer's first income year in which the qualified child care or development facility construction, expansion, or rehabilitation is completed and the initial enrollment of children by the child care provider or child development program occurs. In the case where this credit exceeds the taxpayer's tax liability, the excess may be carried over until the credit is exhausted.

The credit shall not apply to loans with a term of less than three years or to loans funded prior to January 1, 2000. The credit shall apply only to interest income from the loan and shall not apply to any other loan fees or other charges collected by the bank or financial corporation with respect to the loan.

"Qualified child care or development facility" is defined as a licensed child care or development facility that:

?? is operated by child care providers that promise to a bank or financial institution lender to provide child care services for the entire term of the loan; and

?? meets one of the following additional requirements:

- ~~is~~ is located in low- or moderate-income areas, as defined by the Community Reinvestment Act of 1977 (Public Law 95-128), as amended; or
- ~~is~~ is operated by child care providers that covenant with the bank or financial institution lender that not less than 30% of the children served by the facility will be from households with incomes at or below 75% of the local median income as published by HUD.

Family day care centers are not qualified facilities.

This credit shall not apply to loans for purchasing land or for refinancing existing loans.

The credit would be disallowed for any year after the occurrence of a disallowing event. A disallowing event occurs if the child care provider 1) defaults on the loan agreement for more than 90 days, 2) ceases providing child care in the facility for which the loan was made for more than 90 days, or 3) if the credit is based on a covenant to have no less than 30% of the children served are from households with incomes at or below 75% of the local median income, if the child care provider ceases providing child care services in compliance with that requirement.

Generally, if the bank or financial corporation sells the loan to another bank or financial corporation, the balance of the credit, if any, shall be transferred to the assignee or transferee of the loan, subject to the same conditions and limitations of the original credit. However, a bank or financial corporation may assign, sell, or otherwise transfer the loan to another person or entity and retain the right to claim the credit granted under this section if the bank or financial corporation retains responsibility for servicing the loan.

Policy Considerations

This credit is attempting to encourage building and improving child care centers for low-income registrants by providing an incentive to lenders to lend necessary construction monies and subsidizing a portion of the foregone interest over the life of a loan made for this purpose. As drafted, the language provides that the behavior of the borrower affects the lender's ability to take the credit. The lender would have to demonstrate compliance by the borrower if audited. This may diminish the incentive to the lender to make such loans.

Federal law prohibits discriminatory state taxation of interest on federal obligations. This bill provides a credit to banks and financial corporations for interest foregone on loans relating to child care facilities. This subsidy could be interpreted to subject interest on federal obligations to a discriminatory state franchise tax in violation of federal law.

Implementation Consideration

As indicated under "Policy Considerations" above, the bill would disallow the credit based upon the occurrence of certain future behavior of the borrower. As a result, the occurrence of a disallowing event would be extremely difficult to determine.

FISCAL IMPACT

Departmental Costs

Implementation of this credit would not significantly impact the department's costs.

Tax Revenue Estimate

Based on the data and assumptions below, revenue losses are estimated as follow

Estimated Revenue Impact				
Taxable/Income Years Beginning On or After January 1, 2001 for the Child Care Facility Credit and Taxable/Income Years Beginning On or After January 1, 2000 for the Tax Credit for Foregone Interest Income on Loans				
Enactment Assumed After June 30, 2000				
Fiscal Years				
(In Thousands)				
	2000-01	2001-02	2002-03	2003-04
Facility Credit	Negligible	-\$900	-\$1,000	-\$1,200
Interest Income Credit	Negligible	Minor	Minor	Minor
Total	Minor	-\$1,400	-\$1,500	-\$1,700

Negligible = Loss less than \$250,000.
Minor = Loss less than \$500,000.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

Facility Credit:

Revenue losses would depend on the amount of new cash contributions and redirected cash contributions of at least \$4,000 per contributor. For purposes of this estimate, it is assumed that contributions will be redirections of amounts usually given to other charitable organizations that are deductible for income tax purposes, or trade or business expenses for employers making contributions for the benefit of employees.

The number of child care centers qualifying under this provision is projected to be 95% of the total new or expanded non-government, for profit centers in California, i.e., 583 centers in 2001. The projected growth rate for centers increases from 4% in 1998 to 8% in 2004 due to factors such as welfare reform, increased funding from the California Department of Education, the increasing demand for child care in California, and the incentive effect of this provision. These factors were also considered in the estimate for centers that will expand existing facilities.

Of the projected 583 new or expanded qualified child care facilities in 2001, it is assumed that 25%, or 146 facilities, will receive three cash contributions averaging \$5,000. The total projected 2001 contribution after the 50% credit limitation is approximately \$1 million. The 2001 offset is projected to be approximately \$100,000 resulting in a 2001 revenue loss of \$900,000.

Estimates were developed in coordination with child care system and facility experts at the National Economic Development and Law Center and the California Child Care Resource and Referral Network.

Interest Income Credit:

This estimate is provided as a rule of thumb for every \$50 million in annual qualified loans and assumes an average loan term of 7.5 years with an average discount rate of 1%.

BOARD POSITION

No Position. At its July 5, 2000, meeting, the Franchise Tax Board agreed to take no position on this bill.

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Attorney	Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1661
As Amended June 15, 2000

AMENDMENT 1

On page 7, line 19, strike out "(g)" and insert:

(i)

AMENDMENT 2

On page 16, line 15, strike out "(g)" and insert:

(i)